



**TEN TALENTS**  
FINANCIAL PLANNING

# Preparing for Retirement: Seven Essentials for Successful Investing in Retirement

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While each person's situation is unique, certain commonalities exist among soon-to-be retirees and the decisions that lie ahead. This whitepaper identifies a few shared attributes and provides some essential planning thoughts for developing an investment plan for retirement.



# The World of Retirement Has Changed.

## What makes today's retirement landscape so unique?

Over the past few decades, the retirement environment has changed dramatically.

In the 1980s and 90s, retirement seemed simple. Many retirees had a pension plan they could count on, an ongoing bull market in both stocks and bonds, quality health insurance, and the restored health of the Social Security program following the 1983 reform.

One of the only benefits of the inflationary early 80s was that the 10-year Treasury continued to yield between eight and nine percent even into the late 80s despite inflation falling to around four percent.

In other words, a worker retiring in the 1980s could have theoretically invested their entire portfolio in Treasuries yielding eight percent, withdrawn four percent, and reinvested the additional four percent for later retirement years\*.

Now, let's fast forward to today.

Retirees face an uphill battle. Pensions—the incomes retirees of generations past depended on—have been eliminated from all but the most stable employers as companies look to save costs.

Following a 40-year bond bull market, interest rates are now rising at an unprecedented pace

resulting in the worst performance for bonds in a century in 2022.

On the equity side, since 2000 alone, we've endured four bear markets. This includes two of the worst in the history of the U.S. stock market, which resulted in a "flat decade," and we've experienced the other two over just the last three years.

Then there's the fact that we've been battling a 40-year high in inflation for a while now.

And not to pile on, but if we add in skyrocketing healthcare costs to the perceived uncertainty around Medicare and Social Security, it's clear that today's retirees face quite a different scenario than generations past.

All that said, having a successful retirement is possible. In this whitepaper, we will discuss seven essential and timeless ideas to help you navigate today's environment and make smart retirement planning decisions.

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\*This is a hypothetical example for illustration purposes only.



# Seven Essentials for Successful Investing in Retirement

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## 1. Have a plan.

This may seem almost too obvious, but in a world of 24/7 financial news, the markets get all the attention. "What should you do with your portfolio based around (insert apocalypse du jour)?" That is, essentially, the only question posed by pundits given that the mantra of the financial media seems to be, "We will do whatever it takes to get you to pay attention to us." And unfortunately, pessimism and fear sell better than everything else.

The problem with this 24/7 news coverage is that it incorrectly encourages you to focus exclusively on your portfolio rather than what will make a real difference in your life; that is, your financial plan.

Think about it this way: If you boarded an airplane and asked the pilot what is likely to have the greatest impact on successfully reaching the desired destination, they would probably respond that the flight plan is most important. It's not the make and model of the airplane or the weather patterns in between. Those are the tools and scenarios to plan with and for rather than the guide.

Your retirement income plan is your flight plan. Your portfolio is just the tool to get you from point A to point B. Given this fact, this is how I believe portfolio decisions should be made:

### **Purpose → Plan → Portfolio**

First, you must decide where you want to go.

- When would you like to retire?
- What do you anticipate doing with your time?
- What other goals do you have?
- Why are these things important to you?
- How much will these things cost?

The answers to those questions and many others serve as the foundation of your financial plan to get you from where you are today to where you would like to go.

And thinking through what you can expect during retirement is what we'll cover next.



## 2. Understand the true objective for a retirement portfolio.

Most often, when I ask soon-to-be retirees what their #1 fear in retirement is, the most common answer is:

"I don't want to run out of money."

That sounds relatively straightforward, but there is a problem. When I ask many of those same individuals what the primary objective of their retirement portfolio is, this is the typical response:

"Preservation of principal."

Many retirees don't realize this, but these two statements are out of alignment. Let me explain.

It surprises many people that the average joint life expectancy of a non-smoking couple retiring at age 62 is 92 years old. This means that there is a 50% chance that one of the two of you will still be around, and therefore require income, *for thirty years or more*.

Just the fact that you are reading this may surprisingly be an indication that you could live longer than this 92-year average, given the impact that education and wealth has on our life expectancy.

Regardless, you will probably need income for longer than you think.

Assuming you are "just average," over the span of a three-decade retirement, there is one thing we

can be sure is going to happen: The price of everything you need to buy will go up. In a world of 3% inflation, the average price increase over a three-decade span is 2.5X.

That means a \$5 box of Cheerios could cost \$12 or more over your 30-year retirement.

Considering the impact that inflation will probably have on your retirement spending needs, it's clear that preservation of principal should not be the goal. On the contrary, I believe the primary objective of any successful retirement portfolio should be **Growth of Income**.

If your portfolio's income is not growing at least as fast as your costs are increasing each year, then you are falling further and further behind as each year passes. Nick Murray calls this "death on the installment plan."

And given the post-pandemic inflation we've experienced, this issue is more evident than ever.

As we said in the introduction, the world of retirement has changed. Before we get into how we can develop a portfolio strategy that may effectively provide a growing income, let's first discuss how you might reframe investment risk in retirement to offer some comfort for the uncertainties that lie ahead.



### 3. Reframe investment risk in retirement.

There is no doubt that short-term market volatility can be scary. But in many cases, this fear is exacerbated by thinking about your retirement portfolio all wrong. Financial advisors and investors regularly evaluate and describe portfolio risk in terms of allocation percentages.

For instance, your portfolio may be 70% equities and 30% fixed-income. If that is the barometer of risk, then you may consider how a portfolio with an allocation like that might perform through a bear market. It is a straightforward calculation.

A 70/30 portfolio would have declined by about 24% in 2008\*<sup>[1]</sup>. This is to be expected through bear markets, but few investors will find that comforting as a quarter of their assets disappear in short order. When your life savings is at stake, you may be more likely to head toward the exits than ride it out.

Therefore, I believe it is valuable to reframe how we view risk, especially during retirement.

Another way of looking at the identical portfolio would be to think of your risk in terms of "years of income" instead of percentage allocations of equities and fixed-income. For example, using the same 70/30 allocation noted above, if you are withdrawing 4% annually, you would have an estimated buffer of 7.5 "years of income" ( $30\% \div 4\%$ ) of low-volatility assets available to bridge the gap allowing the markets time to recover before you might need to sell equities.

For reference, during the second worst bear market in U.S. stock market history, the time from the market peak in October 2007 to full price recovery, *not including dividends*, was 5.5 years.<sup>[2]</sup>

It should be obvious that one key to successful investing in retirement is the avoidance of big mistakes that are often made during bear markets. Reframing how you view and address feared market volatility can go a long way to helping you stay patient when patience is in short supply.

You can do the same math noted above for your portfolio by asking the question:

Based on your expected withdrawal needs, how long would a market downturn have to last before you would need to sell a portion of your equities to maintain your lifestyle?

Balancing your comfort level with what your needs are is where the rubber meets the road. And figuring out what the "right number" is for you is an exercise we go through with our clients, and we'd be happy to do for you as well.

\*This is based on a portfolio of 70% S&P 500 Index and 30% Bloomberg Barclays U.S. Aggregate Bond Index. This is a hypothetical example for illustration purposes only.

[1] <https://money.com/can-your-retirement-portfolio-survive-a-stock-market-crash-heres-how-to-tell/>

[2] <https://politicalcalculations.blogspot.com/2006/12/sp-500-at-your-fingertips.html#.Y3eqmfdOlaR>



## 4. Understand the role of equities (stocks) in retirement.

Now that we have reframed risk, it's time to reframe how most investors look at equities. In many cases, people view "stocks" with about the same level of uncertainty as a slot machine in a Las Vegas casino.

Ironically, the entirety of their (and our) investing lives has told a completely different story. A revisit of the last thirty years may be helpful:

Suppose you had \$1,000,000 in January 1993 and invested those funds in a standard portfolio allocation of 75% equities and 25% fixed income. What would have happened to your dividend income and investment balance of the equity portion since that time?

Based on an initial equity investment of \$750,000 into the plain-vanilla S&P 500 index<sup>[3][4]</sup>, we can see that the dividend income would have grown about 5X from ~\$21,000 per year to ~\$115,000 per year\*. This would happen during a period when inflation increased only ~2X!

If that's not enough for you, let's review what happened to your portfolio balance of equities. They would have grown quite nicely as well. Assuming your dividends were paid 100% in cash for your income purposes, your underlying principal (remember, this is what most investors worry about) would have grown from \$750,000 to about \$6,700,000<sup>[3][4]</sup> over the same period.

This is the overlooked miracle of equities and dividends. Lest anyone believe that this is cherry-

picked data, this data just represents the most recent thirty years<sup>[4]</sup> and includes four total bear markets, two of which were the 2<sup>nd</sup> and 3<sup>rd</sup> largest declines in the history of the U.S. stock market. Not to mention, our endpoint is in the middle of the 4<sup>th</sup> bear market noted above.

It's clear that as scary as each bear market has been, patience has been of much greater value than investor intervention.

If we recall from Essential #2, the primary goal of a retirement portfolio is to provide a growing income that meets or exceeds inflation and to accrete principal if possible. A portfolio consisting of dividend-paying equities with our buffer of low-volatility assets for our "years of income" is one way we may accomplish this goal.

Now, how might you consider investing your portfolio?

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\*This is a hypothetical example for illustration purposes only. One cannot invest directly in an index.

[3] <https://politicalcalculations.blogspot.com/2006/12/sp-500-at-your-fingertips.html#.Y8rA4xdOnOj>

[4] Using the link from <sup>[2]</sup> with a beginning month of January 1993 and ending December 2022.



## 5. The value of dividend growth investing for retirement.

As we've discussed previously, if the joint life expectancy for a non-smoking couple is age 92 and the prices during retirement are likely to increase 2-3X (or more), then the obvious goal of a portfolio is Growth of Income. As we prefaced in the role of equities in retirement, a dividend growth portfolio is uniquely suited for this purpose.

Before we get into the basics of the dividend growth philosophy, let's start with what a dividend growth strategy is not. It is not a thinly veiled attempt to "beat the market" (though I don't rule it out). It's not an attempt to create the highest-yielding portfolio nor a foolproof way to eliminate common behavioral investing mistakes.

But if we seek a reliable income that has comfortably outpaced inflation throughout history, dividend growth investing might be it.

Remarkably, since 1960, while inflation averaged about 3% per year, the cash dividend the S&P 500 index paid grew from \$1.98 to \$68.34 through 2022 which is a compound annual growth rate of 5.8%<sup>[5][6]</sup>. In other words, your dividend income would have almost doubled the inflation rate through all sorts of market environments.

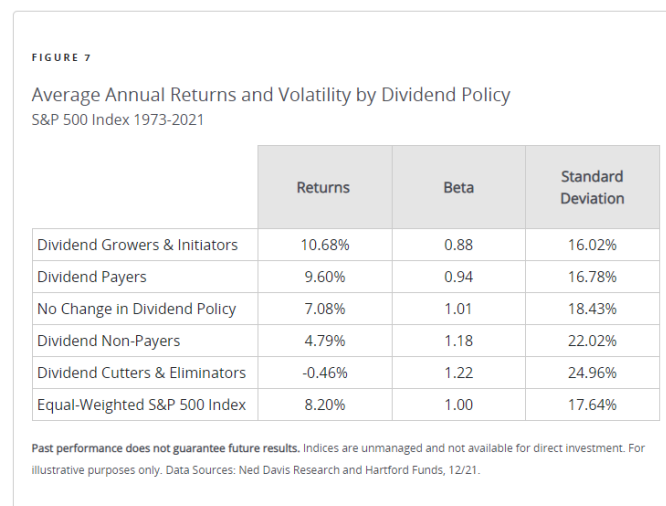
Importantly and amazingly, that is the dividend growth rate of the entire S&P 500, not just the dividend growers—a significant distinction.

One issue that often causes stress in the minds of retirees is the idea of "what to sell, and when" to create the income they need depending on what is going on in the market. Depending on your

required income needs, this dividend growth strategy has the potential to leave your principal

intact. In other words, you may not have to sell anything, thereby eliminating the stress of "what to sell and when."

Making dividend growth even more appealing is that dividend growers as a group tend to be less volatile than their peers as the research from Ned Davis<sup>[7]</sup> shows below, which may help tame our emotional desire to sell when volatility rises.



So, while dividend growth investing may not be the answer for everything, it can serve as a solid foundation for income generation and growth in retirement.

[5][http://pages.stern.nyu.edu/~adamodar/New\\_Home\\_Page/datafile/histretSP.html](http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html)

[6][http://pages.stern.nyu.edu/~adamodar/New\\_Home\\_Page/datafile/spearn.htm](http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/spearn.htm)

[7]<https://www.hartfordfunds.com/insights/market-perspectives/equity/the-power-of-dividends.html>





## 6. Manage your portfolio tax burden.

In retirement, there is obviously more to consider than just investing. One particular area of importance is managing your tax burden. And there are a few taxes (and phantom taxes) that deserve our attention.

One phantom tax that catches many retirees off-guard is the Income-Related Monthly Adjustment Amount for Medicare, commonly known as IRMAA. These additional Medicare premiums are often incurred due to significant increases in taxable income due to IRA Required Minimum Distributions (RMD) which many diligent savers experience. In these cases, RMDs can push retirees into higher tax and Medicare IRMAA brackets, resulting in increased taxes and Medicare premiums.

I refer to this additional premium as a phantom tax because it is not technically a tax, but I can assure you it feels just as bad, if not worse. One way to avoid this "tax" is to manage asset location and the timing of IRA withdrawals. More on this in a moment.

A second tax burden to manage is that of your taxable account. This could be a single or joint registered account or a Trust account. By properly managing these investments using a combination of ETFs, low-turnover index funds, and municipal bonds, you may greatly reduce the taxes owed as a result of your taxable accounts.

Pairing these two tax topics together offer various tax-planning opportunities. For example, suppose

after completing an analysis, you find that completing a Roth conversion is a prudent strategy. In that case, you may sell pieces of your taxable account (while managing capital gains) to pay the taxes on the converted IRA amounts. This may reduce your future RMD taxable income, thereby avoiding tax bracket drift and IRMAA charges over time. This is a complex planning idea you will want to ensure is done correctly to avoid any IRS surprises.

There are other tax strategies to consider as well. Here are a few examples:

In years when, for whatever reason, you have lower distributions than usual, you may consider "filling up" a tax bracket by completing conversions or purposefully recognizing capital gains to create more distribution flexibility in later years.

In years when the markets are volatile, completing tax-loss harvesting may offer more tax-efficient withdrawals or rebalancing opportunities down the road.

If giving to non-profit organizations is important to you, you may consider Qualified Charitable Distributions or gifting appreciated securities instead of making cash donations.

Like most areas of financial planning, managing your tax burden is an area that requires constant attention, but it can offer a significant return on time invested if it's properly managed.





## 7. Should you work with an advisor?

Our bias on this topic is obvious. As you have probably figured out by now, retirement income planning is much more complex than accumulation planning. Beyond the investing and tax-related decisions noted in this whitepaper, there are many important decisions to be made regarding Social Security, Medicare, estate planning, long-term care, and more that require your attention.

Additionally, beyond the expertise a good advisor can provide in the areas noted above, empathetic objectivity is another significant area of value. When the markets are in turmoil, having a partner who can offer comfort and evidence-based reassurance in the plan that was purposefully built for your long-term success can be invaluable. The interesting thing is that the value here can never be known in advance. But I can tell you from personal experience that if and when the time comes, the value of true objectivity cannot be overstated.

Lastly, life's unfortunate reality is that we are all getting older. Over time, having a trusted partner to ensure you make the best long-term decisions for you *and* your spouse may offer great comfort. And as somebody who has been on the other end of this, if you are the primary financial decision maker in your home, having a trusted advisor whom your spouse can count on if something happens to you may be worth more to you and your spouse than all other benefits combined.

That said, deciding who to partner with for your retirement journey is an important decision, so I would like to offer a few questions worth asking your potential candidates:

1. Are you a fiduciary?
2. What services do you provide?
3. What would a typical year of client service look and feel like?
4. What are your philosophies around creating an effective retirement income strategy?

Candidly, you may rightly believe that you can manage your own financial affairs in retirement. The question is, do you want to commit the time and energy to ensure a successful retirement, or would you prefer to partner with an advisor who can walk with you every step of the way?

The choice is yours to make. If you're ready to begin that decision process, we would love to have a friendly conversation to discuss what a relationship with our firm might look and feel like.

### Thank you for reading.

Regardless of how you decide to plan for your retirement, I hope this paper provides some helpful insights into what you may consider when planning for your future.

If you're interested in learning more about what we do and how we help our clients, please be encouraged to [visit our website](#) or give us a call. I wish you great success in your retirement journey!



Kaleb Paddock, CFP® provides financial planning and portfolio management for retirees and pre-retirees.

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- Creation and ongoing maintenance of a long-term retirement income strategy.
- Social Security optimization.
- Assistance with Medicare decisions.
- Pro-active guidance on all matters that could impact your financial goals, such as tax strategy, insurance (life & long-term care), estate planning, charitable giving, and more.
- We will collaborate with your professional partners (CPAs, Estate Attorneys, etc.) at your discretion to ensure a coordinated effort.

## Portfolio Management

- Retirement-specific portfolio income strategies.
- Managed using low-cost, tax-efficient ETFs and passively managed mutual funds.
- Accounts managed holistically across a family's accounts: brokerage, IRA(s), 401(k)s, etc.
- Manage tax withholdings on all IRA withdrawals.

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Visit [www.tentalentsfp.com](http://www.tentalentsfp.com)

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